

REBUTTAL TESTIMONY  
OF  
SAMUEL S. MCCLERREN  
TELECOMMUNICATIONS DIVISION  
ILLINOIS COMMERCE COMMISSION

FRONTIER COMMUNICATIONS CORPORATION,  
VERIZON COMMUNICATIONS, INC., VERIZON NORTH INC.,  
VERIZON SOUTH INC., NEW COMMUNICATIONS OF THE CAROLINAS, INC.  
JOINT APPLICATION FOR APPROVAL OF A REORGANIZATION  
PURSUANT TO SECTION 7-204 OF  
THE PUBLIC UTILITIES ACT

DOCKET NO. 09-0268

DECEMBER 14, 2009

1 **Q. Please state your name and business address.**

2 A. My name is Samuel S. McClerren and my business address is 527 East Capitol  
3 Avenue, Springfield, Illinois 62794.  
4

5 **Q. Are you the same Samuel S. McClerren that previously provided direct**  
6 **testimony in this proceeding?**

7 A. Yes, I am.  
8

9 **Q. What is the purpose of your rebuttal testimony?**

10 A. I respond to issues raised by Frontier and Verizon witnesses in their rebuttal  
11 testimonies, as well as to issues raised in the direct testimonies of other  
12 intervenors' witnesses. More specifically, I respond to the rebuttal testimonies of  
13 Daniel McCarthy, Frontier Exhibit 5.0 and Carl Erhart, Verizon Exhibit 6.0, as well  
14 as to portions of the direct testimonies of International Brotherhood of Electrical  
15 Workers (IBEW) witnesses Randy Barber, IBEW Ex. 1.0 and Susan Baldwin,  
16 IBEW Ex. 2.0; the direct testimony of the Illinois Attorney General and Citizens  
17 Utility Board (AG/CUB) witness Dr. Lee Selwyn, AG/CUB Ex. 1.0; and the direct  
18 testimony of Comcast witness William Solis.<sup>1</sup>  
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<sup>1</sup> Comcast has not marked its prefiled direct testimony for identification.

**Responses to Rebuttal Testimonies of Frontier and Verizon Witnesses**

**Frontier Witness Mr. Daniel McCarthy**

**Q. Relative to Frontier witness Mr. Daniel McCarthy, what issues do you address in your rebuttal?**

A. In his rebuttal testimony, Mr. McCarthy indicates that: (1) Frontier's reorganization is fundamentally different than FairPoint's reorganization with Verizon (pgs. 6, 52 and 78); (2) my "per access line" calculation is irrelevant (pgs. 16-17); (3) there is substantial, although incomplete, acceptance by the Company of the condition I propose in my direct testimony regarding operations support systems ("OSS") (pgs. 22-23); and (4) my service quality condition, for which deteriorating service quality performance may result in dividend restrictions to the Frontier parent company, is unwarranted (pgs. 32-36).

**Q. Mr. McCarthy indicates that this reorganization is fundamentally different than the previous FairPoint/Verizon reorganization. Do you agree?**

A. No. As noted in my direct testimony, both the FairPoint/Verizon and Frontier/Verizon transactions were facilitated through a Reverse Morris Trust transaction, the joint petitions in both transactions were very similar and made the same representations about (1) no adverse effect on services, (2) both purchasing companies had experience and success in dealing with rural and

43 small urban areas, (3) financial benefits such as cash flow and greater access to  
44 financial markets, (4) previous reorganization integration efforts, and (5) back  
45 office information technology support.<sup>2</sup> It should also be noted that Verizon is  
46 the common selling party in both transactions. I consider the FairPoint/Verizon  
47 reorganization to be very similar to this reorganization, and the risks to likewise  
48 be very similar.

49  
50 Accordingly, the best way to successfully implement the requested  
51 reorganization is to acknowledge the similarities in the two proceedings, learn  
52 from the problems that diminished FairPoint's service quality, and develop an  
53 approach designed to mitigate those risks in this proceeding.

54  
55 **Q. Why did Mr. McCarthy indicate that this reorganization is fundamentally**  
56 **different than the previous FairPoint/Verizon reorganization?**

57 A. Mr. McCarthy argues that FairPoint's problems arose from its business decision  
58 to create an entirely new and untested OSS, and that this approach will not occur  
59 in this transaction. (pg. 6). This observation does not speak directly to  
60 differences between the FairPoint/Verizon and Frontier/Verizon transactions, but  
61 rather to their planned implementation. I note that FairPoint did not have  
62 difficulty with its systems for nearly a year after closing because they used the  
63 former Verizon systems as a "bridge" to a cutover of its OSS systems. At  
64 cutover, FairPoint experienced extreme service quality difficulties.

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<sup>2</sup> Direct Testimony of Samuel S. McClerren, ICC Staff Exhibit 1.0, pages 26-27.

65  
66 In fact, that process is very similar to what Frontier is committing to here.  
67 Frontier intends to utilize Verizon's systems, and has assured Staff that it will not  
68 attempt a "cutover" to its own systems for at least 12 months after closing.  
69 However, until such time as Frontier transitions to its own systems and ceases  
70 using Verizon's systems and OSS support, it will be required to pay to Verizon an  
71 annual fee of \$94 million. This provides Frontier with a strong incentive to  
72 migrate systems to its own platforms at an early date. An excessively early  
73 transition of systems and OSS support is, according to Mr. McCarthy's own  
74 testimony, largely the reason for the problems FairPoint has encountered.

75  
76 At pages 52 and 78 of his rebuttal testimony, Mr. McCarthy also contends that  
77 the CenturyTel/Embarq reorganization is more comparable to this transaction  
78 than the FairPoint/Verizon transaction. I understand Mr. McCarthy's comparison  
79 of scale and scope between the two reorganizations, but a review of the Final  
80 Order in the CenturyTel/Embarq reorganization indicates that Verizon was not a  
81 common party to the reorganization, and that "no incremental debt is  
82 contemplated in connection with the transaction."<sup>3</sup> In this proceeding, it is my  
83 understanding that Frontier will ultimately acquire an undetermined but  
84 substantial amount of incremental debt, at an undetermined interest rate.

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<sup>3</sup> Docket No. 08-0645, Final Order, pg. 3 (March 25, 2009).

86 Also, at page 78 of his rebuttal testimony, Mr. McCarthy indicates that the Illinois  
87 Commerce Commission (“Commission”) approved the CenturyTel/Embarq  
88 reorganization without conditions.<sup>4</sup> That contention is erroneous. In its Final  
89 Order in Docket No. 08-0645, the Commission imposed conditions very similar to  
90 the conditions Staff recommends in this proceeding.<sup>5</sup> Any differences between  
91 the two sets of conditions reflects Staff’s desire to create fair and appropriate  
92 safeguards to assure that there will be no degradation of service quality.  
93

94 **Q. Mr. McCarthy, at pgs 16-17 of his rebuttal testimony, indicates that your**  
95 **concern about “per access line cost” was not justified. How do you**  
96 **respond?**

97 A. Mr. McCarthy missed the point of my concern about the lack of a “per access line  
98 cost” calculation. My concern was that Frontier appears not to have performed  
99 an initial high level, cursory analysis of the transaction. To me, it reflected a lack  
100 of interest in operational detail on the part of Frontier’s management with respect  
101 to the decision-making process regarding this proposed transaction. When  
102 combined with Frontier’s lack of on-site facility observation in Illinois, this caused  
103 me to question Frontier’s due diligence.  
104

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<sup>4</sup> McCarthy Rebuttal, Frontier Exhibit 5.0, pg. 78, lines 1935-1938.

<sup>5</sup> See Docket No. 08-0645, pgs. 16-18 (March 25, 2009)

105 **Q. You indicate that Mr. McCarthy discusses the condition you propose in your**  
106 **direct testimony regarding OSS (pgs. 22-23). How do you respond Mr.**  
107 **Carthy?**

108 A. Mr. McCarthy agrees, on behalf of Frontier, to my proposed OSS condition, with  
109 one significant omission. Specifically, Mr. McCarthy does not suggest that the  
110 company seek approval of any new OSS system. It was my position in Direct  
111 Testimony, and remains my position in Rebuttal Testimony, that if Frontier wants  
112 to do an OSS cutover in the three years after the closing date, it must present an  
113 OSS integration plan to the Commission's Chief Telephone Engineer prior to  
114 initiating the OSS cutover. The Chief Telephone Engineer would review the plan  
115 and prepare a report for the Commission regarding the same, recommending, if  
116 necessary, that a proceeding be initiated to determine the adequacy of the plan.

117  
118 I understand that Frontier may consider this OSS requirement to impinge upon  
119 their managerial rights and responsibilities, but I believe that the condition is  
120 necessary to assure that the problems experienced by FairPoint are avoided  
121 here. Frontier has made the condition necessary by requesting approval of this  
122 reorganization without providing adequate OSS cutover information, thus making  
123 it impossible for the Commission to determine whether the cutover associated  
124 with this reorganization will diminish Frontier's ability to provide adequate reliable  
125 efficient service .

127 **Q. Mr. McCarthy believes the service quality/dividend restriction condition is**  
128 **not necessary (pgs. 32-36). Do you agree?**

129 A. Mr. McCarthy states that the service quality/dividend restriction condition is  
130 unnecessary,<sup>6</sup> and lists two concerns with the condition. However, the concerns  
131 may be basis for modifications of Staff's proposed conditions,<sup>7</sup> but are not reasons  
132 for rejection. Mr. McCarthy's concerns are apparently limited to requiring quarterly  
133 rather than annual reporting, and he recommends placing a three year limit to the  
134 condition rather than an investment grade requirement. Nonetheless, I believe the  
135 service quality/dividend restriction condition is necessary. It is designed to make  
136 certain that Frontier maintains the level of service quality currently provided to  
137 customers in Verizon North and Verizon South territories. If it does not maintain  
138 service quality levels, Frontier will be unable to distribute dividends to its corporate  
139 parent, and will be expected to use those withheld dividends to restore service  
140 quality to previous levels.

141  
142 Regarding quarterly versus the recommended annual reporting cycle, I believe  
143 quarterly reporting is an inappropriately short time frame. Assume that Frontier  
144 does indeed let service quality decline for a majority of standards, thereby  
145 triggering the dividend restriction condition. It is my opinion that it will take longer  
146 than 3 months to identify the cause of the service quality problems, develop a  
147 corrective strategy, implement that strategy, and compile the results, especially

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<sup>6</sup> McCarthy Rebuttal, Frontier Exhibit 5.0, pg. 34, lines 883-884.



148 since I understand that FairPoint has taken over a year to accomplish this in the  
149 New England states. Accordingly, while it is appropriate to shorten the reporting  
150 cycle to 6 months when the dividend restriction has been activated, I do not  
151 believe a quarterly reporting interval is appropriate.

152  
153 Staff witness Rochelle Phipps will address Mr. McCarthy's request to change the  
154 duration of the condition.

155  
156 **Verizon Witness Mr. Carl Erhart**

157 **Q. Relative to Verizon witness Mr. Carl Erhart, what issue would you like to**  
158 **address in your rebuttal?**

159 A. In his rebuttal testimony, Mr. Erhart states, at page 13, that an attachment to my  
160 Direct Testimony contained an entry error. Mr. Erhart questions my entry on page  
161 6 of Attachment 2 that reports the Out of Service < 24 hour monthly performance  
162 for Verizon Illinois as well as all Frontier Illinois companies. Specifically, Mr. Erhart  
163 notes that in January 2009, Verizon Illinois' Out of Service < 24 Hours  
164 performance should have been 95%, rather than the reported 94%.

165  
166 **Q. Is Mr. Erhart correct about this entry error?**

167 A. Yes. Verizon Illinois' January 2009 Out of Service < 24 Hours should have been  
168 95%, not 94%. While this entry error does not change my overall concern about

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<sup>7</sup> *Ibid*, pg. 35, lines 894-896 & 903-905, regarding quarterly results rather than annual and using a three year time frame rather than simply investment grade to end the condition.

Verizon Illinois' performance on Out of Service < 24 Hours, and it does not impact my calculation in Attachment 3 regarding Verizon Illinois' 12 Month Average, the correct value is 95%.

**Responses to Direct Testimonies of Intervenor Witnesses**

**Q. What are the issues identified in the direct testimonies of intervenor witnesses that you address here?**

A. There are three issues presented in the direct testimonies that I address: (1) "Skin in the game" recommendation; (2) Third party audit to determine prevalence of service issues; and (3) Third party audit of OSS integration efforts.

**Q What is the "skin in the game" recommendation?**

A. IBEW witnesses Randy Barber<sup>8</sup> and Susan Baldwin,<sup>9</sup> as well as AG/CUB witness Dr. Lee Selwyn,<sup>10</sup> all recommend a "skin in the game" condition. Such condition is designed to maintain a Verizon financial exposure in the current Verizon Illinois service territory after the proposed reorganization's closing date. The objective of the condition is to prohibit Verizon from simply walking away after the transaction, leaving Frontier to suffer the financial pitfalls realized in both Verizon Hawaii and Verizon New England.

**Q. Does this proposed condition appeal to you at all?**

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<sup>8</sup> IBEW Exhibit 1.0 at pg. 57.

<sup>9</sup> IBEW Exhibit 2.0 at pg. 38.

190 A. It has appealing aspects. If Frontier Illinois has been sold a “pig in a poke,” so to  
191 speak, Verizon Illinois should be unable to “monetize” the telephone plant paid  
192 for by Illinois customers over decades and leave.

193  
194 **Q. Do you then embrace and support a “skin in the game” condition?**

195 A. No, for three reasons. First, I do not believe the Verizon Illinois properties are a  
196 “pig in a poke.” While there are isolated reports about a limited number of  
197 service calls taking far too long to be resolved at Verizon Illinois, reported service  
198 quality indicates that Verizon Illinois’ plant is operating in a manner indicative of  
199 acceptable service levels. As shown in Attachment 3 to my Direct Testimony,  
200 Verizon Illinois has averaged 1.03 trouble reports over a twelve month period.  
201 Relative to a Part 730 standard of 6 trouble reports, 1.03 trouble reports is well  
202 within the acceptable range. Further, Commission Telecommunications  
203 Engineering Staff has performed an inspection of all of Verizon’s 82 host central  
204 offices, with no substantial problems found. Finally, the Commission’s  
205 Consumer Services Division (“CSD”) has received only a modest number of  
206 complaints about Verizon Illinois service quality..

207  
208 Second, it is difficult to envision any “skin in the game” condition that does not  
209 create an opportunity for economic distortion. The following thought is not meant  
210 to impugn the integrity of Frontier, or any purchaser, as my observation is purely  
211 theoretical. I postulate that a “guarantee” program developed to maintain a

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<sup>10</sup> AG/CUB Exhibit 1.0 at pg. 68.

212 financial commitment on the selling party after a sale is consummated becomes  
213 an unintentional disincentive to the purchasing party to operate as efficiently as  
214 possible after the closing. For example, if the seller has a \$10 million “skin in the  
215 game” guarantee condition when the purchaser misses service quality standards,  
216 the purchaser may be perversely attracted to the \$10 million pool of “free”  
217 money. In order to receive the \$10 million guarantee that the seller has  
218 committed to providing, the purchaser may have to experience declining service  
219 quality. The purchaser may then be incented to allow service quality to decline in  
220 order to obtain the \$10 million from the seller.

221  
222 Third, while I am not an attorney, it is my understanding that there may be legal  
223 issues with the Commission effectively ordering a renegotiation of the sale.  
224

225 **Q. Who recommended a condition regarding using a third party audit to**  
226 **determine the prevalence of service issues?**

227 A. Ms. Baldwin recommends a third party audit be conducted of Verizon Illinois’  
228 plant to assess the prevalence of temporary closures, battery back-up power,  
229 presence of moisture in cables, FCC outage incidents, and the extent of  
230 defective plant.<sup>11</sup>  
231

232 **Q. What is your opinion regarding a third party audit to assess service**  
233 **issues?**

234 A. The objective of this proposed audit is not clear to me. If Ms. Baldwin anticipates  
235 using the results of a service issues audit in this proceeding, it would be very  
236 difficult to accomplish at this point from a timing perspective. Developing the  
237 scope for such a review, as well as finding a satisfactory consulting firm,  
238 conducting the review, and developing a report would certainly take longer than  
239 available in this proceeding.

240  
241 Regardless of the audit's purpose, for the reasons noted previously, I do not  
242 believe Verizon Illinois' plant is substandard. A trouble report rate of 1.03 reports  
243 per thousand lines, the results of the Commission's central office inspection  
244 program, and customer complaints to the Commission's CSD all support a  
245 conclusion that Verizon Illinois' plant is in acceptable condition.

246  
247 **Q. Who recommended a third party audit of OSS integration efforts?**

248 A. Ms. Baldwin<sup>12</sup> and Mr. Solis<sup>13</sup> both propose a condition requiring an independent  
249 third party review of Frontier's OSS.

250  
251 **Q. What are your thoughts on the need for an independent third party review**  
252 **of Frontier's OSS?**

253 A. BearingPoint, previously KPMG, conducted an independent, third party review of  
254 SBC's (now AT&T Illinois) OSS as part of the Section 271 approval process in

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<sup>11</sup> IBEW Exhibit 2.0, Direct Testimony of Susan Baldwin, pg. 83.

<sup>12</sup> *Ibid*, pg. 86.

255 Illinois. Originally, the audit was conceived as a result of a condition in the SBC-  
256 Ameritech reorganization, and KPMG was awarded the contract. The auditor's  
257 proposal originally projected the cost at approximately \$20 million, but before it  
258 was completed, the cost had ballooned to over \$55 million. I bring up this recent  
259 history to point out that third party, independent reviews of OSS can be  
260 extremely expensive, with unanticipated costs not unlikely. Such audits should  
261 therefore not be ordered without compelling need.

262  
263 In this reorganization, I am less concerned about the replication process that  
264 Frontier contemplates for at least a year after closing than I am about what will  
265 ultimately be a cutover process. My understanding is that in the short term,  
266 Verizon systems will still be operated by former Verizon personnel and that a  
267 support and maintenance OSS agreement with Verizon will be in place. I note  
268 that even in the FairPoint situation, service quality problems did not manifest  
269 themselves to a significant degree until nearly a year after closing, coinciding  
270 with the cessation of Verizon's OSS and with the cutover to FairPoint's newly-  
271 developed OSS. When Frontier decides to perform a similar cutover process  
272 from Verizon's OSS to its own systems, OSS difficulties will likely be more  
273 significant than the OSS difficulties due to the replication process.

274  
275 As the Commission is contemplating whether or not to allow this reorganization  
276 to go forward, Staff intends to submit an on-the-record data request to Frontier

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<sup>13</sup> Comcast, Direct Testimony of William Solis, pgs. 32-34.

277 asking that Frontier provide information regarding the status of the replication  
278 process at least 30 days prior to closing to ascertain that the replication process  
279 is proceeding smoothly. If Frontier reports problems with its assessment of the  
280 replication process, Staff will take such further action as it deems necessary.

281  
282 **Q. What is your position on this proposed reorganization?**

283 A. As indicated in my Direct Testimony, as described in the original petition and  
284 relative to Section 7-204(b)(1), I do not support the proposed reorganization,  
285 absent the imposition of the conditions proposed by Staff.

286  
287 **Q. If the service quality and OSS system conditions are accepted by Frontier,**  
288 **relative to Section 7-204(b)(1), would your position change?**

289 A. Yes. I believe that the service quality and OSS conditions contained in my Direct  
290 Testimony are necessary to provide assurance to the Commission that service  
291 quality will not decline. In the event of service quality failures that trigger the  
292 dividend restriction, I support a 6 month reporting cycle for the earliest removal of  
293 the dividend restriction.

294  
295 Regarding OSS modifications after closing that would be considered a cutover  
296 from current Verizon systems, I believe review by the Commission's Chief  
297 Telephone Engineer, and potentially approval of the Commission, is a necessity.

299     **Q.     Does this conclude your testimony?**

300     **A.     Yes, it does**



## Verizon and Frontier Illinois Service Quality Part 730.535 – Out of Service < 24 Hours Standard – 95%

	July 2008	Aug. 2008	Sep. 2008	Oct. 2008	Nov. 2008	Dec. 2008	Jan. 2009	Feb. 2009	Mar. 2009	Apr. 2009	May 2009	June 2009
Verizon (North & South)	96	<u>94</u>	95	97	95	98	95	96	96	96	<u>93</u>	95
Frontier Citizens	<u>77</u>	<u>83</u>	<u>84</u>	<u>89</u>	<u>93</u>	<u>89</u>	<u>92</u>	95	98	97	96	95
Frontier DePue	<u>75</u>	<u>50</u>	100	100	100	100	100	100	100	<u>92</u>	100	100
Frontier Illinois	100	<u>76</u>	<u>84</u>	<u>85</u>	<u>93</u>	<u>79</u>	<u>89</u>	<u>92</u>	<u>94</u>	<u>80</u>	98	<u>90</u>
Frontier Lakeside	100	<u>88</u>	100	100	100	100	100	100	100	100	100	100
Frontier Mt. Pulaski	<u>83</u>	100	100	<u>86</u>	100	100	100	100	100	100	100	100
Frontier Orion	100	100	<u>91</u>	100	100	100	100	100	100	100	100	100
Frontier Midland	<u>68</u>	<u>87</u>	<u>73</u>	<u>67</u>	<u>93</u>	<u>94</u>	96	100	<u>93</u>	98	100	97
Frontier Prairie	<u>67</u>	100	<u>93</u>	100	100	100	100	100	100	100	100	<u>75</u>
Frontier Schuyler	<u>85</u>	<u>92</u>	95	100	<u>88</u>	100	100	100	<u>92</u>	100	100	100

Monthly Service Quality Failures Are Underlined.